BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
TITLE GUARANTY COMPANY)

Appearances:

For Appellant: J. A. Omstein, Assistant Secretary; Royal E. Handlos, Attorney at Law.
For Respondent: W. M. Walsh, Assistant Franchise Tax Commissioner; James J. Arditto, Franchise Tax Counsel.

O P I N I O N

This appeal is made pursuant to Section 19 of the Corporation Income Tax Act (Chapter 765, Statutes of 1937, as amended) from the action of the Franchise Tax Commissioner in overruling the protest of Title Guaranty Company to a proposed assessment of additional tax in the amount of $3,096.56 for the taxable year ended December 31, 1937.

In its return of income for 1937 the Appellant included in its gross income dividends received by it from the following companies in the amounts indicated:

Western Title Insurance Company	$19,515
Sacramento Abstract and Title Company	11,854
Title Insurance and Guaranty Company	32,092

Acting in reliance upon Section 7(h) of the Act, Appellant deducted the amount of such dividends in computing its net income, The Commissioner, however, disallowed the deduction of the entire amount of the dividends received from the Western Title Insurance Company and the Title Insurance and Guaranty Company and allowed the deduction of those received from the Sacramento Abstract and Title Company to the extent of $11,651.65.

The issue presented herein as respects the deductibility of the dividends received from the Western Title Insurance Company and the Sacramento Abstract and Title Company (neither of which was taxable on its gross premiums as an insurance company) is identical with that involved in the Appeal of Solano County Title Company, this day decided by us. Each Company received its entire income from sources within this State and reported that income for purposes of the Bank and Corporation Franchise Tax Act. The major portion of the income of Western was derived from dividends paid to it by various operating title companies

whose respective incomes were also reported for franchise tax purposes. Sacramento derived its income principally from its title operations, but also received some dividends from other operating title companies whose respective incomes were subject to the franchise tax. It follows, accordingly, that the dividends received by the Appellant from Western and Sacramento are deductible under Section 7(h) of the Corporation Income Tax Act in their entirety under Burton E. Green Investment Company v. McColgan, 60 Cal. App. (2d) 224; hearing in California Supreme Court denied October 11, 1943.

A different issue arises, however, as respects the dividends received by the Appellant from the Title Insurance and Guaranty Company. This Company is an insurance company subject to the gross premiums tax then imposed on such companies under Section 14 of Article XIII of the California Constitution. It also received certain income from non-insurance business and reported and paid a tax under the Bank and Corporation Franchise Tax Act with respect to $4,424.55 derived from such business. Although only about 10.7 per cent of the income of the Title Insurance and Guaranty Company was included in the measure of the franchise tax, Appellant claimed a deduction for dividends received from the Company in the amount of $32,092 which represents the entire amount of the dividends received from it. In support of his action in disallowing the deduction, the Commissioner cites the Appeal of Security Title Insurance and Guarantee Company (June 22, 1938). in which we held that an insurance company taxable on its gross premiums under Section 14 of Article XIII of the California Constitution was not taxable under the Bank and Corporation Franchise Tax Act with respect to income derived from non-insurance business.

It is true, as the Appellant points out, that the Commissioner's action is inconsistent with his position that the franchise tax applies with respect to the non-insurance income of an insurance company. Apparently not being satisfied with our decision in the Security Title Insurance and Guarantee Company matter, the Commissioner requested the advice of the Attorney General as to "whether an insurance company which is taxable on gross premium receipts pursuant to Section 14-3/4 of Article XIII of the Constitution may be subjected to a tax on net income, under the Bank and Corporation Franchise Tax Act, received by it from sources other than insurance premiums." After pointing out in his opinion of January 12, 1940, that there was no judicial decision squarely in point and that there was no logical reason for exempting insurance companies from taxation on non-insurance income, the Attorney General concluded as follows:

> "After careful consideration of the matter I believe the proper course to pursue is for the Commissioner to assesstaxes on such non-insurance income and thus bring about a situation where a test case can be brought and the matter judicially determined."

So far as' appears from the record before us, the amount of

franchise tax paid by the Title Insurance and Guaranty Company was not paid pursuant to an assessment of tax levied by the Commissioner, but was rather paid in connection with a return voluntarily filed by it under the Bank and Corporation Franchise Tax Act. While, as above mentioned, the Commissioner's position is inconsistent, it may be observed that inconsistent administrative rulings of this type are at times made as the only possible means for the protection of the public revenues prior to a judicial determination of the point at issue.

Be that as it may, however, we are again confronted with the question whether the franchise tax may be applied with respect to the non-insurance income of an insurance company subject to the gross premiums tax, for if that question be answered in the negative, dividends received from such a company are not "declared out of income which has been included in the measure of the tax imposed by the Bank and Corporation Franchise Tax Act, Statutes 1929, Chapter 13 as amended, upon the bank or corporation declaring the dividend;." Section 7(h), Corporation Income Tax Act (underscoring added). We know of no reason to depart from the view which we expressed on this question in the Security Title Insurance and Guarantee Company Appeal.

The Attorney General did not go so far as to state in his opinion of January 12, 1940, that he believed that the non-insurance income of an insurance company was clearly subject to the franchise tax. He points out that the question had not yet been passed upon by the appellate courts of the State, admitted that there was some doubt as to what the Supreme Court might hold thereon, stated that there was no logical reason to exempt the income from taxation, and concluded that under these circumstances it would be advisable for the Commissioner to continue to assess the tax on the non-insurance income and thus make possible a test case in which the question might be judicially determined. So far as we are informed, the Supreme Court has not as yet passed upon the question.

There is, however, a decision of the District Court of Appeal which is of great assistance so far as the matter under consideration is concerned. In John McClure Estate, Inc. v. Johnson, 53 Cal. App. 512, decided July 23, 1942, the Court had before it a factual situation which it described as follows:

> "Appellant is a domestic corporation doing business in the State of California. Appellant received dividends on stock owned by it in an insurance company doing business in California and paying the insurance tax on gross premiums imposed during the year 1937, the income year in question, by Section 14 of Article XIII of the California Constitution. The dividends received by appellant were paid by the insurance company in part from gross premium income and in part from investment income. Appellant contended that, in computing its net income for 1937 by which its franchise tax for 1938 was measured, all the dividends received by it from the insurance company were deductible. The

> "Franchise Tax dommissioner, respondent here, refused to allow any of such dividends to be deducted and increased appellant's tax accordingly. After paying the additional tax appellant instituted this action for the recovery thereof."

The Court then upheld the position of the Franchise Tax Commissioner, stating in the course of its opinion

> "It is clear that under the Constitution and the laws of this state insurance companies do not pay the franchise tax provided for in the Bank and Corporation Franchise Tax Act. It is equally clear from the above quoted constitutional provisions Sections 14 and 16 of Article XIII that it is not intended to subject insurance companies to the payment of such a tax. The Constitution provides another method of taxing insurance companies; and the measure of such taxation is distinctly different from that provided for the taxation of corporations by the Bank and Corporation Franchise Tax Act. . . Whether the gross premiums tax is considered as a tax 'in lieu' of the franchise tax or otherwise, the necessary conclusion to be derived from the foregoing constitutional provisions is that insurance companies are not subject to the franchise tax provided by the Bank and Corporation Franchise Tax Act. ..
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> "It cannot be disputed that section 8(h) of the Bank and Corporation Franchise Tax Act the wording of which is almost identical with that of Section 7(h) of the Corporation Income Tax Act applies only to the levy of the tax provided by that act. Since the franchise tax provided by that act is not imposed upon an insurance company it necessarily follows that a dividend declared from income of an insurance company cannot be held to have been declared from income which has been included in the measure of the tax imposed by the Bank and Corporation Franchise Tax Act."

It is true the Court then went on to point out, that even thoughitbe assumed (a) that insurance companies were subject to the Franchise Act, (b) that Section 8(h) of that Act applied to dividends of insurance companies, and (c) that the gross premiums tax was in lieu of the franchise tax, it could not be held that the dividends in question were declared from income which had been included in the measure of that tax. This followed, the Court said, "because the gross premiums alone constitute the only measure of the tax imposed upon an insurance company, and it is not shown what portion of the dividends were declared from premiums," There is nothing in the Court's opinion to indicate that the insurance company there in question paid a tax under the Bank and Corporation Franchise Tax Act with respect to any of its non-premium income.

It might be contended that the narrowest ground of decision

in the McClure Estate case must be taken as the rule of the case and that it, accordingly, stands only for the proposition that dividends paid by an insurance company, which has not paid the franchise tax with respect to its non-insurance income, if any, are not deductible by the recipient under Section 8(h) of the Bank and Corporation Franchise Tax Act in the absence of a showing of the portion thereof declared from premiums. It should be observed, however, that the Court did not base its decision primarily on this ground. It first held that insurance companies are not subject to the Bank and Corporation Franchise Tax Act and then went on to point out the lack of a showing of the portion of the dividends declared from premiums as an additional ground for its decision.

Until such time, accordingly, as our Courts shall rule otherwise, we shall adhere to the view expressed in the Appeal of Security Title Insurance and Guarantee Company that an insurance company subject to the gross premium tax imposed by the Constitution on such companies is not subject to the Bank and Corporation Franchise Tax Act. It follows from this view that the dividends paid by the Title Insurance and Guaranty Company t.o Appellant are not deductible under Section 7(h) of the Corporatior Income Tax Act since they were not declared from income taxed under that Act to the declaror corporation or from income includec in the measure of the tax imposed by the Bank and Corporation Franchise Tax Act upon the declaror corporation,

O R D E R

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED that the action of Chas. J. McColgan, Franchise Tax Commissioner, in overruling the protest of Title Guaranty Company to a proposed assessment of additional tax in the amount of $3,096.56 for the taxable year ended December 31, 1937, pursuant to Chapter 765, Statutes of 1937, as amended, be and the same is hereby modified as follows: Said Commissioner is hereby directed to allow the deduction from gross income, under Section 7(h) of said Act, of dividends received from Western Title Insurance Company in the amount of $19,515 and Sacramento Abstract and Title Company in the amount of $11,854; in all other respects the action of the Commissioner is hereby sustained.

Done at Sacramento, California, this 11th day of May, 1944, by the State Board of Equalization.

R. E. Collins, Chairman
Wm. G. Bonelli, Member
Geo. R. Reilly, Member
Harry B. Riley, Member
J. H. Quinn, Member

ATTEST: Dixwell L. Pierce, Secretary